

## Message Text

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ACTION ARA-10

INFO OCT-01 ISO-00 AID-05 CIAE-00 COME-00 EB-07 FRB-03

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LAB-04 SIL-01 OMB-01 PA-01 PRS-01 USIA-06 AGR-05

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P R 252159Z APR 75

FM AMEMBASSY SANTIAGO

TO SECSTATE WASHDC PRIORITY 3080

INFO AMEMBASSY BUENOS AIRES

AMEMBASSY LA PAZ

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E.O. 11652: N/A

TAGS: ECON, CI

SUBJECT: CHILE'S ECONOMIC RECOVERY PROGRAM

1. SUMMARY. IN NATIONAL RADIO AND TELEVISION BROADCAST ON APRIL 24, ECONOMIC SUPER MINISTER JORGE CAUAS OUTLINED GOC'S PROGRAM FOR ECONOMIC RECOVERY. MAIN AIM OF PROGRAM IS TO BRING INFLATION UNDER CONTROL BY REDUCING PUBLIC SECTOR EXPENDITURES BY 15 TO 25 PERCENT AND BY INCREASING GOVERNMENT REVENUES FROM INCOME, PROPERTY, SUMPTUARY AND VALUE-ADDED TAXES. GOVERNMENT'S WORK-RELIEF PROGRAM WILL BE EXPANDED TO ABSORB ADDITIONAL UNEMPLOYMENT WHICH WILL RESULT FROM BUDGET CUTBACK. CAUAS PROMISED THAT WHILE ANTI-INFLATION PROGRAM IMPLIES GREAT SACRIFICES, WITHIN FAIRLY SHORT PERIOD MEASURES WILL RESULT IN ROBUST AND INFLATION-FREE ECONOMY READY FOR ECONOMIC TAKE-OFF. EMBASSY BELIEVES MEASURES PROPOSED BY CAUAS ARE APPROPRIATE. HOWEVER, WE ARE LESS SANGUINE THAN HE THAT BENEFITS OF POLICIES WILL BE CLEARLY VISIBLE IN RELATIVELY SHORT TIME. END SUMMARY.

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2. IN SPEECH CARRIED ON NATIONAL RADIO-TELEVISION HOOKUP

EVENING APRIL 24, GOC'S FINANCE MINISTER AND NEWLY DESIGNATED ECONOMIC SUPER MINISTER JORGE CAUAS OUTLINED PROGRAM OF ECONOMIC RECOVERY WHICH, ACCORDING TO CAUAS, WOULD BRING INFLATION UNDER CONTROL AND OPEN UP SOUND GROWTH POSSIBILITIES FOR CHILEAN ECONOMY IN NOT TOO DISTANT FUTURE.

3. MAIN AIM OF PROGRAM IS TO REDUCE RAPIDLY CHILE'S VERY HIGH RATE OF INFLATION BY SHARP CUTBACK IN GOVERNMENT BUDGET DEFICIT. CAUAS ANNOUNCED THAT EXPENDITURES OF PUBLIC SECTOR WILL BE CUT BY 15 TO 25 PERCENT. ALTHOUGH CAUAS LEFT UNSEPCIFIED TIME FRAME IN WHICH EXPENDITURE REDUCTIONS OF THIS MAGNITUDE WOULD BE EFFECTED, IMPLICATION WAS THAT THEY WOULD BE UNDERTAKEN ALMOST IMMEDIATELY. SINCE HE MENTIONED DECREASES IN PURCHASES OF GOODS AND SERVICES, PRESUMPTION IS THAT PROGRAM WILL AFFECT BOTH PUBLIC SECTOR EMPLOYMENT AND INVESTMENT PROGRAMS.

4. IN FURTHER STEP TO REDUCE GOVERNMENT DEFICIT AND PRIVATE CONSUMPTION, CAUAS SAID THAT PROGRESSIVE SURTAX ON INCOME WOULD BE INCREASED BY TEN PERCENT, THAT EXCISE TAXES ON SUMPTUARY GOODS WOULD BE RAISED BY ADDITIONAL TEN PERCENT, AND THAT LIST OF ITEMS EXECPTED FROM VALUE ADDED TAX (VAT) WOULD BE REDUCED TO BREAD, FRESH MILK, FRUITS AND FRESH VEGETABLES. ALL TAX INCREASES APPARENTLY WILL BECOME EFFECTIVE EITHER IMMEDIATELY OR BY MAY 1. (RAW MATERIALS AND ALL FOODSTUFFS ARE CURRENTLY EXEMPTED FROM VAT.)

5. CAUAS SAID THAT WITH ADOPTION OF FOREGOING MEASURES GOC EXPECTS FISCAL DEFICIT TO BE REDUCED TO "INSIGNIFICANT LEVEL" DURING SECOND HALF OF 1975 AND THAT THIS WOULD BE TRANSLATED INTO VERY LOW RATE OF INFLATION. HE DID NOT QUANTIFY FURTHER. (PRESUMABLY FIVE PERCENT A MONTH INFLATION WOULD IN CURRENT CHILEAN CONTEXT BE CONSIDERED SMALL.)

6. DESPITE FISCAL AUSTERITY, GOVERNMENT WILL MAINTAIN FOR TIME BEING PRESENT PROGRAM OF AUTOMATIC WAGE ADJUSTMENTS IN ACCORDANCE WITH PREVIOUS THREE MONTHS' RATE OF CPI INFLATION. CAUAS HINTED, HOWEVER, THAT WHEN RATE OF INFLATION DECREASES TO MORE ACCEPTABLE LEVEL, PROGRAM MIGHT BE REVISED (AS INFLATION DECREASES, REAL INCOMES WOULD RISE IF CURRENT THREE-LIMITED OFFICIAL USE

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MONTH ADJUSTMENT LAG MAINTAINED).

7. TO SOFTEN IMPACT OF ADDITIONAL UNEMPLOYMENT, WHICH WILL RESULT FROM BUDGET STRINGENCY, GOC WILL EXPAND MUNICIPAL WORK PROGRAM. CAUAS SAID THAT FISCAL INCENTIVES WILL BE INTRODUCED TO ENCOURAGE MORE LABOR-INTENSIVE PROCESSES OF PRODUCTION AND THAT EXPORTS WILL BE ENCOURAGED THROUGH POLICY OF ACCELERATED DEPRECIATION. (CAUAS DID NOT ELABORATE,

BUT LATTER PRESUMABLY MEANS CAPITAL EQUIPMENT USED FOR PRODUCTION OF EXPORTS WILL BE GIVEN PREFERENTIAL TAX TREATMENT.)

8. CAUAS PLEDGED THAT GOC WILL CONTINUE FREQUENT ADJUSTMENTS OF EXCHANGE RATE IN ACCORDANCE WITH RATE OF DOMESTIC PRICE INFLATION. FURTHER WITH REGARD TO EXTERNAL POLICY, CAUAS REITERATED PREVIOUSLY STATED GOC OBJECTIVE TO REDUCE MAXIMUM TARIFF RATES TO 60 PERCENT BY JANUARY 1, 1977.

9. BUSINESSMEN WERE WARNED BY CAUAS THAT THEY WOULD HAVE TO COOPERATE WITH GOVERNMENT POLICY IN ORDER NOT TO BE CONFRONTED WITH UNSUSTAINABLE FINANCIAL SITUATION. IF THEY TRY TO RAISE PRICES IN FACE OF REDUCED DEMAND, HE PREDICTED FALLING SALES, HIGHER INVENTORIES AND FINANCIAL LOSSES. HE SAID FURTHER IN THIS CONNECTION THAT GOVERNMENT WOULD NOT LISTEN TO TARDY LAMENTS OF THOSE WHO DID NOT BELIEVE IN GOC POLICY. (WE READ THIS TO MEAN THAT IN FUTURE GOC WILL NOT EXTEND EXTRA CREDITS TO BUSINESSES WITH LIQUIDITY PROBLEMS.) IN RESPONSE TO RECENT PUBLIC NERVOUSNESS ABOUT SOUNDNESS OF VARIOUS FINANCIAL INSTITUTIONS, MINISTER REITERATED GOVERNMENT'S PLEDGE OF FULL BACKING OF BANKS AND SAVINGS AND LOAN ASSOCIATIONS.

10. CAUAS CLAIMED THAT RECOVERY PERIOD WOULD BE SHORT, BUT FILLED WITH SACRIFICES AND ABSTINENCES. ONCE DIFFICULTIES ARE SURMOUNTED, HE PROMISED CHILE WOULD EXPERIENCE RATE OF DEVELOPMENT UNLIKE ANY IT HAS KNOWN BEFORE.

11. COMMENT: GOC FIGHT AGAINST INFLATION HAS FALTERED BECAUSE GOALS SET IN GRADUALIST APPROACH TO AUSTERITY HAVE NOT BEEN MET. CAUAS' PROPOSALS (IF CONSCIENTIOUSLY IMPLEMENTED) WILL CUT MORE DEEPLY AND QUICKLY THAN WAS PLANNED A FEW MONTHS AGO. EMBASSY BELIEVES PROGRAM OUTLINED BY CAUAS APPROPRIATE TO LIMITED OFFICIAL USE

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CURRENT CHILEAN ECONOMIC CIRCUMSTANCES ALTHOUGH WE ARE LESS OPTIMISTIC THAN CAUAS ABOUT SPEED WITH WHICH CHILEAN ECONOMY WILL ADJUST TO NEW CIRCUMSTANCES. JUNTA HAS PLACED ECONOMIC POLICY AT LEAST TEMPORARILY IN HANDS OF CIVILIAN ECONOMISTS. THEY WILL HAVE TO ANSWER IF PROGRAM FAILS TO PRODUCE IN ACCORDANCE WITH JUNTA EXPECTATIONS.

12. SPEECH LACKED SUFFICIENT SPECIFICS ON PROMISED BUDGET REDUCTIONS FOR EMBASSY TO ANALYZE PROBABLE EFFECTS. ECONOMIES IN OPERATION OF GOVERNMENT DECENTRALIZED AGENCIES AND PUBLIC ENTERPRISES WILL UNDOUBTEDLY BE A MAJOR FACTOR. CANCELLATION OF SOME GOVERNMENTAL AND PUBLIC SECTOR INVESTMENT PROGRAMS WILL ALSO CONTRIBUTE TO GOAL. ALMOST CERTAINLY THESE CUTBACKS WILL MEAN CONSIDERABLE REDUCTION IN PUBLIC SECTOR EMPLOYMENT. REDUCED AGGREGATE DEMAND AND PROBABLE

LAGS IN PRICE ADJUSTMENTS WILL ALSO CONTRIBUTE TO INCREASING  
SIGNIFICANTLY CHILE'S ALREADY HIGH RATE OF UNEMPLOYMENT.

13. FURTHER ANALYSIS WILL FOLLOW AS MORE DETAILS OF PROGRAM  
BECOME AVAILABLE. WE WILL ALSO REPORT PUBLIC REACTIONS, SOME  
OF WHICH ARE LIKELY TO BE CRITICAL.  
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## Message Attributes

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